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TAGS: [ECON](#) [EFIN](#) [ENRG](#) [PREL](#) [RS](#)
SUBJECT: MERRIL LYNCH RUSSIA CEO DISMISSES LIKELIHOOD OF
ECONOMIC REFORMS UNDER MEDVEDEV

REF: MOSCOW 709

Classified By: ECMIN Eric T. Schultz, Reasons 1.4 (b/d).

Summary

11. (C) Former Central Bank First Deputy Chairman, and current CEO of Merrill Lynch in Russia, Sergei Aleksashenko told us he did not anticipate that President-elect Medvedev would implement any pro-market reforms. Medvedev would be too weak and dependent on Putin to make major changes and would face resistance from vested interests. Moreover, the current strength of the Russian economy eliminated the requisite sense of urgency to begin a program of reforms. That said, Aleksashenko acknowledged that the Russian economy faced serious challenges but they were all long-term and only present-tense crises would command the GOR's attention. End Summary.

Krasnoyarsk "Just Rhetoric"

12. (C) Aleksashenko, who clarified he was offering his personal views as opposed to those of Merrill Lynch, said he was not optimistic that the vision outlined in President-elect Medvedev's February 15 Krasnoyarsk speech would be realized. The pro-market rhetoric was "nice" but it was just rhetoric. If you looked at Putin's campaign speeches of 2000 you would see similar rhetoric. The primary cause for Putin's stalled reform efforts was a lack of political will. Putin had had the power to combat the corruption he decried in his State Council address on February 8. He had also had the power to improve the country's education and health care systems and make other changes. Aleksashenko expressed doubt that Medvedev would muster the will to succeed where Putin had not.

13. (C) Moreover, Aleksashenko said Medvedev was unlikely to command the kind of political loyalty that Putin enjoyed, at least initially. For one thing, Putin would probably retain his hold on the "reins of power" for the first year while Medvedev made the "big change from First Deputy Prime Minister to President." This transition period would serve as a brake on any momentum for initiating reform. Putin might leave the post of Prime Minister after this transition, but even that would not "free" Medvedev to initiate reforms. Putin would retain influence but more importantly power would

still be concentrated in Putin's friends "who were not necessarily Medvedev's friends" and these vested interests would likely oppose reforms.

Economic Environment Unfriendly to Reform

¶4. (C) In addition to a lack of political will, Aleksashenko said the reality of Russia's current prosperity and macroeconomic stability would discourage the prospects for reform. "By any measure, Russia is in good shape economically and it is difficult for any government to undertake reforms in such an environment." According to Aleksashenko, the GOR would feel no pressure to take action in the absence of an external shock, such as a significant fall in oil revenues. However, the current account is balanced at USD 65 a barrel and the price of oil was unlikely to fall any where near that level. In fact, it was more likely that prices would continue to rise over time as demand continued to rise.

¶5. (C) According to Aleksashenko, Russia's budding status as a safe financial haven was yet another factor eliminating the necessary sense of urgency behind successful reform efforts. The strengthening ruble, steady real GDP growth since 2000, domestic political stability, and the absence of mortgage-related problems had sustained Russia's attractiveness in the midst of a slump in developed economies' financial markets. Russian companies had substantially increased their foreign debt in the last year, to nearly \$400 billion, 25 percent of it short-term debt.

¶6. (C) Aleksashenko said Merrill Lynch had anticipated that Russian companies might have trouble refinancing this

short-term in the wake of the U.S. sub-prime mortgage crisis. However, in the fourth quarter of 2007, not only had Russian companies refinanced \$20 billion in short term debt, they had raised an additional \$15 billion. As long as foreign capital was flowing into the country it was hard to argue that Russia needed, for instance, to improve its investment regime.

Threats to Prosperity Distant

¶7. (C) Aleksashenko said that although Russia's current prosperity militated against reform that did not mean there were no problems in the Russian economy. Senior GOR officials understood the need to tackle corruption and strengthen property rights if the country were to maximize its economic potential. There was a significant difference between the six percent growth Russia was likely to see in the next few years and the eight percent it was capable of but that difference would only be apparent over time and the GOR would only address these structural problems when it had to.

¶8. (C) Along the same lines, Aleksashenko added the threats to the oil sector were real but distant. For instance, the emergence of an oil substitution model, whereby factories and vehicles used something besides oil as an energy source, could reduce demand and lack of upstream incentives could reduce production, especially of oil. However, these problems would not begin to be felt until 2020, if current rates of development continued. In the interval, the Russian economy was likely to continue to rely heavily on the export of hydrocarbons and other natural resources rather than diversifying.

Comment

¶9. (C) Aleksashenko's pessimism is well-grounded in reality. Russia's government would not be the first to delay needed long-term reforms in the absence of any compelling short-term

need. We can, however, see at least a few problems that could crop up short term that could force Medvedev's hand, such as rising inflation and infrastructure bottlenecks.

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